

TAX & BUSINESS STRATEGIES

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Don't Expect Huge Tax Savings with Low Inflation Rate in 2010

To keep taxpayers from being pushed into higher tax brackets or from losing tax benefits simply because of inflation, the federal tax code since the 1980s has included inflation adjustments for tax brackets, exemptions, high-income phase-outs of various deductions and limitations, allowable retirement savings and the annual gift-tax exclusion, just to mention a few. For example, indexing tax brackets lowers tax bills when there is inflation by including more of one's income in a lower bracket, such as the 15% rather than the 25% bracket.

In 2010, for the first time ever, those inflation adjustments will be virtually nil because of a very low inflation rate. This means that taxpayers with the same taxable income in 2010 as in 2009 will not see much of a tax savings due to inflation. For example, joint filers with a taxable income of \$100,000 will pay approximately \$13 less in income taxes in 2010 than on the same income for 2009, compared with a \$313 savings between 2008 and 2009. A single filer with taxable income of \$50,000 will owe \$6 less next year, compared to a \$156 savings due to the significantly higher inflation rate between 2008 and 2009.

The lack of change for 2010 creates a level playing field for taxpayers from all brackets, but those with high incomes actually stand to benefit in 2010 because "stealth taxes," those that don't involve changing tax rates, are being phased out. Among them are limits on itemized deductions and personal exemption amounts.



Dear Client:

This has been a year filled with many tax law changes, with the government doing its best to provide tax incentives to those in need. Despite their efforts, many taxpayers are finding themselves unemployed or receiving a smaller paycheck and just barely making ends meet. With this in mind, an article has been entirely devoted to year-end tax strategies to help keep your tax liabilities to a minimum.

The tax strategies included in this edition deal with energy-efficient home improvements, Roth IRA conversions, capital loss carryovers and non-cash charitable donations, just to name a few. These are frequently-encountered tax strategies that can be employed by most, but may not apply to all, depending on your specific situation. Please call for an appointment if you need help determining if any of these strategies may apply to you.

2009 has not been a great year for most individuals. However, if your business is considering expansion or capital purchases, now may be the time to act. Some business benefits may no longer be available after the close of 2009 without Congressional action.

Another surprise will come your way in 2010. For the first time ever, inflation adjustments will be virtually nil because of a very low inflation rate. Taxpayers with the same taxable income in 2010 as in 2009 will not see much of a tax savings due to inflation.

A year-end tax planning consultation would be beneficial, especially to those who have a substantial increase or decrease in income this year. With tax season just right around the corner, don't wait too long to figure out a strategy. By planning ahead, you can ensure that you are maximizing your tax savings.

Year-End Tax-Saving Strategies to Keep Your 2009 Tax Bite Low

With the sluggish economy, 2009 has not been a great year for most individuals. Unemployment is up, incomes are lower, retirement savings have declined, and many taxpayers are struggling to make ends meet. The government has provided a variety of tax incentives to help weather the economic storm, and you are urged to take advantage of these special tax benefits as well as other strategies to keep your 2009 tax bite as low as possible. Note: Some of the strategies below deal with ways to increase a taxpayer's itemized deductions.

State Estimated Tax Payments – Although the deadline to make the fourth-quarter 2009 state estimated tax payment is January 15, 2010 for most states, the payment will count as a tax deduction on the federal Schedule A for 2009 if that payment is made before the end of December 2009.

Property Taxes – Generally, your property taxes are billed in installments, and that is how most people pay them. However, the tax can be paid all at once, if it provides a greater tax benefit for the current year.

Caution: The preceding two strategies do not benefit taxpayers who are subject to the alternative minimum tax (AMT), since taxes are not deductible to the extent a taxpayer is subject to the AMT. Taxpayers subject to the AMT might, instead, consider deferring deductible tax payments to the subsequent year.

Required Minimum Distributions (RMDs) from Retirement Plans – Except for delayed 2008 distributions, RMDs are not required for 2009. Congress enacted this one-year relief so that an individual's retirement accounts could recover from the market downturn. However, if you are in a low or zero tax bracket, it may be to your benefit to take a withdrawal anyway. RMDs generally apply to individuals age 70½ and older, but even younger retirees who are not yet required to take a distribution may find this strategy beneficial. If you receive Social Security benefits, IRA distributions can sometimes be planned to minimize the taxability of the Social Security income.

Tax Credit for First Four Years of College – The new American Opportunity Credit (AOC) takes the place of the Hope education credit and provides a credit for tuition and certain other expenses of the first four years of college (Hope only applied to the first two years). So even if you used the Hope credit in prior years, you can qualify for the AOC. The credit is 100% of the first \$2,000 of qualified expenses and 25% of the next \$2,000. Forty percent of the credit is refundable, which means that taxpayers with little or no tax liability can still benefit from the credit. Where appropriate, taxpayers can prepay the tuition for academic terms starting in the first three months of 2010 to help maximize the benefit for 2009. This credit does begin to phase-out for single taxpayers with AGI above \$80,000 (\$160,000 for joint filers), and no credit is allowed for taxpayers filing married separately.

Energy-Efficient Home Improvements – Homeowners who have or will make certain energy-efficient improvements to their existing homes may qualify for energy credits up to 30% of the cost (credit limited to \$1,500). This credit applies to the following qualified energy-efficient improvements: exterior windows and skylights, exterior doors, metal and asphalt roofs, heating systems, air-conditioning systems and insulation. With many contractors without work, this could be an opportune time to negotiate reasonable prices and make those home modifications, but the work must be completed before the year's end if you want a credit in 2009.

Roth IRA Conversions – If your taxable income is low or a negative amount for the year, it may be appropriate to convert some or all of your taxable traditional IRA to a Roth IRA for little or no tax cost.

Review Estimated Tax Payments and Withholding – You should ensure that your estimated tax payments and withholding are sufficient to meet the "safe-harbor" payment amounts so as to avoid underpayment penalties. This is important this year because the federal government modified the withholding tables to account for the new "Making Work Pay Credit," resulting in reduced withholding and possible underpayments, especially in cases where a taxpayer has two jobs or both spouses are employed.

IRA and Self-Employed Retirement Plan Contributions – The primary purpose of IRA and self-employed retirement plans is to provide for your future retirement; whenever you are eligible and financially able, you should always contribute as much as possible. Contributions also provide a tax deduction when they are made to self-employed plans and to most traditional IRAs. The benefit derived from this tax deduction is based upon your tax bracket. (Some contributions to traditional IRAs may not be deductible if you also participate in another retirement plan, depending on your income level.) If 2009 was not a good year financially for you, the deduction may not be significant, and you may wish to consider making a Roth IRA contribution instead. An individual who simply prefers the Roth option, but is barred from making Roth contributions because his income exceeds the AGI phase-out limitations, might consider making a nondeductible traditional IRA contribution and then converting it to a Roth IRA in 2010 when the Roth IRA AGI limitations are removed.

Capital Loss Carryovers – If you have carryover capital losses, remember that you can only claim a maximum of \$3,000 net capital loss on your return and that the remainder carries over to the subsequent year. However, with the market's recent rally, you may have some gains you can take to offset the carryover. (If you sell at a gain but wish to repurchase stock in the same company, note that the wash sale rules don't apply – they only apply to losses – so you will not need to wait 30 days to make the repurchase.) For long-term planning, it is important to keep in mind that the current lower capital gains rates of 0% and 15% are only available through 2010. After that, without Congressional intervention, the rates return to the pre-2003 levels of 10% and 20%.

Non-Cash Charitable Donations – If you itemize your deductions and your garage and closets contain never-used items, consider donating those items to charity before the year-end to increase your deductions for 2009. To claim a deduction for donated clothing and household goods, they must be in good condition or better, and the donations must be substantiated by a written receipt that includes the name of the charity, dates and location of the donation and a reasonably detailed description of the property donated. A receipt is not required where the value is less than \$250 and it is impractical to obtain one (for example, when items are left at an unattended drop site). If, instead, you decide to sell some of the property, the income is generally tax-free, provided each item is sold for less than your cost or basis in the property.

The foregoing are frequently-encountered tax strategies that can be employed by most, but by no means all, taxpayers. Please call this office if you have questions regarding any of the topics discussed or would like to engage in some year-end tax planning. If you have a substantial increase or decrease in income this year, it may be wise to schedule an appointment before the holidays to strategize.

Taxes & Worker Status: Employee vs. Independent Contractor?

If you are a small business owner, whether you hire people as independent contractors or as employees will impact the amount of taxes you withhold from their paychecks, as well as the amount and types of taxes you pay. Furthermore, it will affect how much additional cost your business must bear, what documents and information must be provided to you, and what tax documents must be given to the individuals you are hiring.

The obvious advantage to treating an individual as an independent contractor is avoiding the added expense of payroll taxes and employee benefits. Unfortunately, the decision is not an optional one, and employers must be careful when making the decision, lest they set themselves up for a payroll audit and back taxes, penalties and interest.

According to industry sources, the IRS will begin auditing companies in early 2010, focusing their efforts on businesses failing to pay taxes on fringe benefits and misclassifying workers as independent contractors instead of W-2 employees.

Here are some things every business owner should know about hiring people as independent contractors versus hiring them as employees.

- Three characteristics are used by the IRS to determine the relationship between businesses and workers: Behavioral Control, Financial Control, and the Type of Relationship.
- Behavioral Control covers facts that show whether the business has a right to direct or control how the work is done through instructions, training or other means.
- Financial Control covers facts that show whether the business has a right to direct or control the financial and business aspects of the worker's job.
- The Type of Relationship factor relates to how the workers and the business owner perceive their relationship.
- If you have the right to control or direct not only what is to be done, but also how it is to be done, then your workers are most likely employees.
- If you can direct or control only the result of the work done, and not the means and methods of accomplishing the result, then your workers are probably independent contractors.
- Employers who misclassify workers as independent contractors can end up with substantial tax bills. Additionally, they can face penalties for failing to pay employment taxes and not filing required tax forms.
- Workers can avoid higher tax bills and lost benefits if they know their proper status.
- Employers can request the IRS to make a determination on whether a specific individual is an independent contractor or an employee by filing a Form SS-8 (Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding) with the IRS. A worker may also file Form SS-8, requesting an IRS determination. IRS does not issue determinations for proposed or hypothetical situations.

If you need more information about the critical determination of a worker's status as an independent contractor or employee, please give this office a call.

Year-End Planning for Capital Purchases

Increased business spending for durable goods and capital items indicates that businesses are beginning to loosen their purse strings. From a tax standpoint, this is also a good time to consider capital purchases, thanks to some extraordinary tax benefits available through the end of the year. If your business is considering expansion or capital purchases, now may be the time to act – because without Congressional action, which is unlikely due to increasing federal budget woes, the following business benefits will no longer be available after the close of 2009.

Bonus Depreciation – Under the first-year bonus depreciation rules, taxpayers may generally claim an additional first-year depreciation deduction equal to 50% of the cost of qualified property placed in service in 2009. This bonus depreciation deduction is allowed for both regular tax and AMT purposes. Qualified property includes equipment and machinery that is purchased new and placed into service before the end of the year.

Luxury Auto Limitations – Generally, vehicles weighing 6,000 pounds or less are classified as luxury vehicles, and the first-year depreciation is 20% of the cost of the vehicle but limited to a maximum of \$2,960 (\$3,060 for light trucks), regardless of the cost of the vehicle. However, for 2009, and at the taxpayer's election, that maximum is increased to \$10,960 (\$11,060 for light trucks). This increase is attributable to the bonus depreciation allowable for 2009.

Enhanced Expensing (Sec. 179) – For equipment and machinery placed in service in 2009, the maximum expensing allowance is \$250,000; it phases out when the cost of eligible property placed in service during the year exceeds \$800,000. Barring any change by Congress, the \$250,000 and \$800,000 amounts will reduce to \$125,000 and \$500,000 in 2010, and drastically decline to \$25,000 and \$200,000 in 2011.

Quick Write-Offs for Most New Farming Machinery and Equipment – Those engaged in a farming business have the opportunity to depreciate qualifying new farming machinery and equipment over a 5-year period, instead of over the generally-applicable 7 years. To qualify, the original use of the property must have begun with the taxpayer after December 31, 2008, and before January 1, 2010. Grain bins, cotton ginning assets, and fences or other land improvements are not eligible for the 5-year write-off period.

Generally, farming machinery and equipment also qualifies for the increased expensing and bonus depreciation deductions previously discussed, providing extraordinarily large tax write-offs for 2009.

15-Year Write-Off for Leasehold Improvements – Qualified leasehold improvements, restaurant improvements, and retail improvements completed and placed into service before January 1, 2010 may be written off over 15 years instead of the usual 39 years. This more than doubles the annual write-off for these improvements.

The options for writing off capital expenditures in 2009 make it possible to customize the write-off for virtually all businesses through careful pre-year-end planning. So whether you wish merely to optimize the write-off for capital purchases already made, or you wish to plan additional purchases to take advantage of the special 2009 tax write-offs, give this office a call. Together we can strategize to maximize your benefits and minimize your tax liability.

November-December 2009:

It's time for 2009 year-end and 2010 tax planning. This is highly recommended if you have substantial increases in income or fewer deductions. Please call for an appointment.

December 31, 2009:

- This is the last day to pay deductible expenses for the 2009 return. This doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2009.
- This is the last day to set up a Keogh Retirement Account if you plan to make a 2009 contribution.

January 15, 2010:

The fourth quarter 2009 federal estimated tax payment is due unless the 2009 return is filed by February 1, 2010. **Caution:** Some states may have different filing dates for state estimated payments.

February 1, 2010:

This is the deadline for providing 1099s and W-2s to those people you paid during 2009. If you are a business owner or rental property owner and you paid \$600 or more for the services of individuals (other than employees) during the year, you will need to provide 1099s to those workers by February 1, 2010. Note that the normal due date is January 31, but because it falls on a

weekend, the due date is the next business day, February 1. "Services" can mean everything from labor and professional fees to rents on property. In addition, in order to avoid a penalty, copies of 1099s need to be sent to the IRS by March 1, 2010. This firm can prepare these documents for you.

March 1, 2010:

This is the deadline for filing (sending) 1099s and W-2s to the government. Note that the normal due date is February 28, but because it falls on a weekend, the due date is the next business day, March 1.

April 15, 2010:

- This is the deadline for individuals to file a 2009 federal return or request an extension of time to file.
- The first installment of the 2010 federal estimated tax payment is due. **Caution:** Some states may have different filing dates for state estimated payments.
- The first installment of the 2010 defined benefit pension plan contributions is due.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

TAX & BUSINESS STRATEGIES

SINCE YOU ASKED...

YOU ASKED: This year I purchased a houseboat that I use as my home. Do I qualify for the first-time homebuyer credit?

ANSWER: In addition to a conventional single family residence, the credit also applies to the purchase of a house trailer, mobile home, houseboat, cooperative apartment, condominium, duplex, or row house used as a taxpayer's primary residence. So, if the houseboat is your primary residence and was purchased this year, and you and your spouse, if married, have not owned a home in the three years prior to the houseboat's purchase, you probably qualify for the credit. Even if you are not a first-time homebuyer, if your purchase was after November 6, 2009, and you had owned the same principal residence for any 5 consecutive years during the 8-year period ending on the date of purchase of the houseboat, you may qualify for a reduced credit. The credit is phased out for higher-income taxpayers. Only the purchase of a main home located in the United States qualifies. Vacation homes and rental properties are not eligible.

YOU ASKED: This year, my wife and I purchased two new vehicles, one costing \$55,000 which included \$3,300 of sales tax, and the other \$42,400 which included \$2,400 of sales tax. Is the sales tax deduction limited to one vehicle or to the first one purchased? I'm confused!

ANSWER: The special sales tax deduction for 2009 allows the tax to be deducted on multiple vehicles purchased between February 17 and December 31 of 2009, but only on the first \$49,500 of the purchase price. You can deduct the tax whether you itemize your deductions or take the standard deduction. In your case, you would be able to deduct \$5,370, which includes \$2,970 (\$3,300 x \$49,500/\$55,000) for the first vehicle and all of the \$2,400 for the second one.